



August 5, 2004

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th St. & Constitution Ave., N.W.
Washington, D.C. 20551

Re: Regulation DD: Docket No. R-1197

Dear Ms. Johnson:

The Consumer Bankers Association (CBA)¹ appreciates the opportunity to submit these comments on the joint agency proposal to address “bounced-check protection” under Regulation DD. We are separately submitting comments on the parallel proposal, Docket No. OP-1198, to issue Interagency Guidance on Overdraft Protection Programs.

1. In General:

CBA wholeheartedly supports the objective of the Federal Reserve Board (“Board”), to assure adequate disclosure of overdraft protection coverage and costs and to prevent misleading marketing of overdraft protection programs. At the threshold, we agree it is preferable to address these concerns under Regulation DD as aspects of consumer deposit accounts, rather than under Regulation Z as extensions of credit. From its beginnings thirty five years ago, Regulation Z has recognized that the occasional payment of overdrafts, without a commitment in advance by the financial institution to do so, should not be subject to full-blown credit cost disclosures under that regulation. The discretionary and short-term nature of overdraft payments flows historically and functionally from the underlying deposit account, and is ill-suited for credit disclosures.

At the same time, customers who maintain deposit accounts may also, and quite properly, receive disclosures under Regulation Z if there is a formal overdraft line of credit related to the account, and under Regulation E if the account has electronic payment functions, as well as disclosures under Regulations CC and DD for the deposit and transaction account aspects. These disclosures may come when the account is opened, on periodic statements thereafter, and occasionally in connection with particular transactions. It is incumbent on the Board, we believe, to maintain a balanced relationship among these disclosures, lest disclosures under one regime create conflicts or distortions under another.

¹ The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

Further, there is a sense in the Board's proposal that the use and marketing of "automated" overdraft systems is intrinsically suspect and undesirable. We completely disagree with that intimation. As discussed below, automation of overdraft programs is as healthy and as inevitable as the introduction of credit scoring on the underwriting side. There is much less risk of irrational or discriminatory practices where the payment vs. dishonor decision rests on an empirical basis which automation provides. As for marketing, of course *false and deceptive* claims or practices should be unlawful – and have been under the FTC Act and other federal and state law for decades. We do not believe that providing overt and accurate information about overdraft systems is undesirable, where that information has traditionally been known only to the institutions themselves. The focus of regulatory and enforcement agencies should be on the accuracy of the information.

2. Scope of coverage

CBA's major concern with the proposal is uncertainty about its scope of coverage. The proposed amendments to Regulation DD would add new disclosures for periodic statements under § 230.6, and would impose new restrictions on advertising concerning certain kinds of overdraft services under § 230.8. There would also be new explanatory Commentary related to the revisions. These new provisions would add significant new compliance responsibilities (reinforced by the accompanying Interagency Guidance), and in the case of the periodic statement disclosures would add programming and operational costs. Before CBA can subscribe to these new rules, our members need to know what kinds of "programs" or activities are affected.

Fairly read, the Supplementary Material expresses concern about some combination of three characteristics of overdraft programs. One is that they are "automated" programs. Two is that they are provided by third-party vendors. Three is that the programs are advertised and marketed to customers, sometimes with overtones of guaranteed overdraft protection. Nothing in the text of the proposals for § 230.6 provides a definition of what subset of institutional practices is intended to be covered by it. Likewise, proposed § 230.8(f) concerning advertising introduces the term "automated overdraft services," but does not define it at all.

These three characteristics are by no means adequate, or even accurate, descriptions of the type of service that we assume the regulation and Guidance are intended to cover. First, overdraft handling is "automated" whether or not the institution uses a third-party vendor or markets the program to its customers. The days of an employee in green eyeshade poring over individual overdraft items are long gone. Overdraft payment decisions are commonly made based on reports generated from institutional databases that are more empirically reliable in predicting risk patterns than subjective individualized assessments. Second, it is rare in our experience for third party vendors to provide overdraft services. Third-party vendors, rather than selling overdraft programs, typically act as consultants, assisting institutions in the use of existing, internal reporting systems. The resulting decisions are more sound and consistent than traditional *ad hoc* systems. Singling them out from those institutions who do not rely on vendors does not provide a rational basis for coverage. Lastly, the concept of marketing, alone, does not create the need for special handling, unless it is more clearly linked to the promotion of misleading information (such as implied guarantee of repayment). It merely creates the impression that any information that may be provided about the program may be a form of marketing that would trigger the coverage of the Guidance and revised Regulation. At face value, therefore, every one of the approximately 20,000 institutions subject to Regulation DD will have to comply with the new requirements on periodic statements and advertising and to the broad prescription of the Guidance.

We urge the Board, therefore, to draft any final version of these regulatory changes with discernible definitional boundaries so that financial institutions are not burdened with regulatory requirements that are not relevant to many of them. The Board might consider different classifications in order to meet different goals. We suggest some possibilities in the comments below. We also would suggest some additional attention be paid to the consistent and clear treatment of terms throughout the rule making (for example, does the term "overdraft fee" include only a flat fee charged at the time the overdraft is paid, or also include periodic fees that may be charged while the account remains overdrawn?).

2. Account-opening disclosures.

Proposed Comment 4(b)(4)-5 would call for an institution to specify whether an overdraft fee “applies to overdrafts created by check, or by ATM withdrawal or other electronic transfer, as applicable,” and not merely provide that the fee is “for overdraft items.” We recommend against this additional piece of information. We know of no evidence that it would provide sufficiently useful information to the consumer to warrant the operational, legal, and other costs that making the change would entail.

3. Periodic statement disclosures.

The requirement in proposed § 230.6(a)(3)(ii) for periodic and annual aggregates of overdraft and returned-item charges is intended, as we understand it, to impress on consumers the costliness of writing overdrafts and, to that extent, to counter the attractiveness of marketing claims for overdraft protection.

- We are unaware of any behavioral data or focus group reactions that support the effectiveness of such disclosures, and we do not believe that the additional information would have the intended effect.
- This will require four new data fields on periodic statements, which will entail considerable financial institution expense for system redesign, training and compliance management. Providing the annual information would add a substantial expense because most institution’s systems, we are told, do not currently aggregate fee information across statement cycles. While we cannot immediately quantify that expense, it is clearly a cost to be offset against any informational gains.
- The requirement to distinguish between overdraft fees and returned item fees would be an unnecessary burden for many institutions, which may charge the same amount for overdrawing an account whether an item is paid or returned.

4. Advertising disclosures

As part of the definition of “advertisement,” the proposal would amend § 230.2(b) to include marketing to existing account holders, and proposed Commentary ¶2(b)-2 elaborates on what is (and is not) an advertisement with respect to existing accounts. It would add clarity if the Commentary paragraph expressly acknowledged that it is not an advertisement if the institution is merely reissuing the basic account agreement (perhaps to add or change provisions that do not require change-in-terms notices under § 230.5). The expanded definition of “advertisement” may also sweep in informational notices that may not have been intended to be covered and which would cause problems if they are. Institutions often provide information to their customers that are not provided by law, but are intended to be valuable disclosures. For example, they may send the consumer an overdraft notice when the consumer overdraws the account. Although not required by law, this could be viewed as a form of promotion.

We have no problem with the listed examples of misleading or inaccurate advertisements in proposed Commentary ¶ 8(a)-10.

Our major concern about the proposed revision to § 230.8 is the ambiguity as to its coverage. The new advertising disclosures would apply to any promotion of an “automated overdraft service,” but without any indication of what that includes or excludes. As noted above, virtually all overdraft services are automated to some degree, in the sense that computerized data systems are used to determine whether overdrafts will be paid or dishonored. Where on the spectrum of primitive to sophisticated “automation” does the proposed regulation focus? Is it essential, or even relevant, whether a third-party vendor is involved? We submit that the involvement of a third-party vendor is irrelevant because ultimately the decision whether to pay or dishonor is the institution’s, not the vendor’s.

It may be that the Board is trying to focus on overdraft systems that are “automatic,” in the sense that decisions are dictated by the system and there is no room for human intervention or institutional discretion. If so, the focus will remain blurred, and the regulatory effort may chill all advertising about overdraft programs. Virtually all overdraft systems of which we are aware emphasize that payment is discretionary. The “automation” aspect of the system synthesizes data according to criteria set by the institution, to allow it to make

decisions reliably and consistently, and *promptly* to meet settlement, posting, and payment deadlines under Regulations J and CC. These criteria may vary from time to time – indeed day to day. The variables affecting payment or dishonor are built into the system. Even so, most systems remain subject to override in individual cases. Thus we find it difficult to agree that special treatment is needed for “automated” but not for “other” kinds of systems.

We therefore urge the Board to rethink how and when special advertising disclosures are appropriate. If the “automated” character of the system remains central, we suggest that the Regulation or Commentary define “automated overdraft service” as one in which a dominant portion of the pay/dishonor determinations are made routinely by a computerized program, even if its determinations are subject to institutional override.

Finally, the proposal, in § 230.8(f)(4), would require that covered advertisements identify “the circumstances under which the institution would not pay an overdraft.” This has the potential for mischief. For one thing, the circumstances in which the institution may exercise its discretion not to pay an item are almost infinitely variable, according to its prevailing sense of risk exposure. A statement of when it will not pay an item could not possibly capture all the circumstances in which the institution would dishonor an overdraft, and the challenge to incorporate all those circumstances in an ad would be daunting. The proposed Commentary ¶ 8(f)-2 seems to bless a generalized statement that the institution will not pay overdrafts “if your account is not in good standing, or you are not making regular deposits, or you have too many overdrafts.” These are three among a possibly limitless list of reasons for dishonor. And it is an invitation to litigation if a refusal to pay is not clearly stated in the prior disclosure. Moreover, the vagueness of this requirement could become a chilling factor for an institution considering advertising an overdraft program. Similarly, it would prove difficult to provide a list of the types of transactions for which a fee for overdrawing an account may be imposed, depending on how much detail is intended to be provided. Consumers benefit from non-misleading advertising, and Regulation DD should not discourage it by imposing complex or onerous requirements.

We appreciate the Board’s consideration of these comments.

Sincerely,

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